Name:		Index Number:		Class:	

DUNMAN HIGH SCHOOL
Preliminary Examination
Year 6

Higher 3 Economics

9808/1

Paper 1

30 September 2015

Additional Materials:
Writing Papers

1400 – 1715
3 hour 15 minutes

READ THESE INSTRUCTIONS FIRST

Write your name and Civics Class in the spaces provided on the answer paper.
Write in dark blue or black pen on both sides of the paper.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **all** questions

Section B
Answer **two** questions

Write your answers on the separate writing paper provided.
At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **7** printed pages including this cover page.

[Turn over

Section A

Answer **all** questions in this section.

1 Economic Woes in the Eurozone

Extract 1: The Eurozone Crisis

It had all started to look quite promising. The US was picking up, China had avoided a hard landing and in Japan the early signs from the new government's anti-deflation approach were encouraging. Then Cyprus came along, bringing the Eurozone crisis back into the spotlight.

Economists at Fathom Consulting draw a comparison between the Eurozone today and the UK at the start of the financial crisis. Mistakes were made with the handling of Northern Rock because of fears that a bailout would create problems of moral hazard – helping a bank that had got itself into trouble through its own stupidity would encourage bad behaviour by others.

Austerity is making matters worse because cuts to public spending and higher taxes hit economic activity by more than they reduce government deficits. Public debt as a share of national incomes goes up, not down. Austerity can work, but conditions have to be right for it. It helps if a country's trading partners are growing robustly, because then the squeeze on domestic demand can be offset by rising exports. It helps if the central bank can compensate for tighter fiscal policy by easing monetary policy, either through lower interest rates or through unconventional measures such as quantitative easing (QE). And it helps if the exchange rate can fall. Not one of these conditions applies in the Eurozone, which is why the fiscal multipliers – the impact of tax and spending policies on growth – are so high. Removing one euro of demand through austerity leads to the loss of more than one euro in GDP.

Source: adapted from *The Guardian*, 1 April 2013

Extract 2: The Crisis of the European Union (EU)

The free movement of goods and services is fundamental to the customs union and a key component of the crisis of the Eurozone. The creation of the Eurozone put 17 countries with varying levels of economic development and competitiveness in a currency union, creating large trade imbalances between the less developed economies in the Eurozone periphery and Germany, Europe's main exporter. Before the introduction of the Euro, countries in the periphery could apply monetary policy to deal with growing current account deficits, but now the common currency has deprived them of that tool.

EU leaders are fighting against tax evasion. Often, residents of EU countries are able to avoid taxation in their country of residence by having bank accounts in another member state. In 2003, the EU tried to solve this problem by getting EU members to agree to implement an automatic exchange of information between states concerning interest payments.

However, Belgium, Austria and Luxembourg objected to the disclosure of account holders' names, arguing that they would not be able to compete with non-EU countries with strong banking sectors such as Switzerland and Liechtenstein. Thus, they were granted exceptions to the system of information exchanging. Countries like France and Spain have seen numerous corruption scandals in which public officials had secret bank accounts in other countries.

While efforts to share banking information are moving forward, two problems remain. The first is enforcement. Second, these information-sharing measures are not designed to prevent capital flight from countries in the periphery to countries in the core.

Source: adapted from *Stratfor Global Intelligence*, 11 April 2013

Extract 3: Greece's Health Crisis

Austerity was designed to shrink debts. Greece, for example, is in the middle of a public health disaster. To meet budget-deficit reduction targets set by the European Central Bank, European Commission, and International Monetary Fund (collectively known as the Troika), Greece's public health budget has been cut by more than 40%. The spending was reduced to 6% of GDP, a figure lower than the UK, at 8%, and Germany, at 9%.

The introduction of co-payments in a country with rapidly falling income levels and increasing inequalities means that more households will be threatened with financial ruin if a household member becomes seriously ill. The UN Rapporteur on Debt and Human Rights reported in 2013 that "nearly one third of the Greek population is without public health insurance, mainly due to prolonged unemployment".

HIV infections jumped by more than 200% since 2010 as needle-exchange programme budgets were cut in half. Since 2008, there has been a rise of more than 40% of people who report being unable to access healthcare that they believe to be medically necessary. As patients cannot afford private care and forgo preventive care, public sector hospitals have experienced a 24% rise in hospital admissions. Over 35,000 public health workers, nurses, and doctors have lost jobs. Doctors and clinics are thus overstrained.

The government policy also reduced the prices of medicines purchased, which has resulted in shortages of medicines for many common conditions, because wholesale pharmaceutical companies have moved to other, better funded markets. Health insurance funds have delayed payments to pharmacies and patients have been asked to pay for drugs themselves.

Unemployment rates hit 27% and youth unemployment jumped to near 75% in some areas. With little hope for the future, desperate people are turning to cheap, synthetic drugs. Use of anti-depressants has skyrocketed, adding costs to the healthcare system. Suicide rates, previously among the lowest in Europe, have soared.

Many patients must now pay up front and wait for subsequent reimbursement by the insurance fund. Findings from a study in Achaia province showed that 70% of respondents said they had insufficient income to purchase the drugs prescribed by their doctors.

Perhaps the most controversial of the reforms was the provision for 500 public hospital beds to be set aside for private insurance companies to use for their clients. It is this last development that reveals the lack of commitment to a publicly funded and universally accessible healthcare service.

In fact, our research has found that each euro invested in public health can yield up to a three euros return if invested wisely in data-supported government programmes. New York City officials learned this lesson in the early 1990s – after restricting its TB prevention budget, the city suffered a drug-resistant TB outbreak that ultimately cost $1.2 billion to control, about 10 times larger than the estimated price of prevention. Greece's HIV, TB, and malaria epidemics will now cost more to control than they would have been to prevent, our research indicates.

Severe, indiscriminate cuts to vital social protection programmes are not only economically self-defeating, but fatal.

Source: adapted from *CNN*, 9 September 2013 and *www.thelancet.com*, 22 February 2014

Extract 4: Government Spending Means Faster Growth?

Cutting government spending on things like public sector salaries, medicines, consultancy advice and other forms of "government consumption" tends to make economies grow faster in the medium term. If businesses are confident that the economy will grow faster in the medium-term, they are more likely to invest today and consumers will be more willing to spend.

There is a trade-off. Up to about 20-25% of GDP, government spending promotes growth. Above 25%, it reduces growth but we get nice things for it that are worth growth being lower. Then, above some figure in the region of 35-60 per cent of GDP, depending upon our political outlook, the trade-off ceases to be worth it.

We can get the economy to grow faster by cutting back on the nice-to-have growth-reducing spending. When economic conditions are poor, especially if we are over-indebted and fear that we may not grow, we might be prepared to sacrifice less growth for those nice-to-haves. Growth isn't everything, and we should not be cutting spending to the level that maximises growth.

Source: adapted from *The Telegraph*, 29 April 2012

Extract 5: A Eurozone Without Greece

A Greek exit (Grexit) would have far-reaching consequences for the Eurozone. A Grexit would resolve the uncertainty over how to leave the single currency. The euro was not designed with an easily accessible escape hatch. If Greece does leave, it will establish a precedent, but not one that others may wish to emulate. Most importantly, if the Greek economy should recover after leaving the Eurozone, it would be much harder to convince others that they should stay.

However, a painful economic afterlife seems far more likely. The Greek economy would get caught in a pincer, with a sharp and sustained contraction in credit and an increase in uncertainty propelling the economy back into a deep recession. There would be a significant risk of further, lasting damage to the Greek economy through the destruction of jobs and firms.

Even the sharp depreciation in the currency would be a double-edged sword. There would be a painful squeeze on disposable income as imports become much more expensive. This would at least partly offset the boost to Greek exports, assuming companies elsewhere in the Eurozone do not reroute supply chains out of Greece to avoid invoices billed in drachma. Likewise, it is brave to assume that there would be an influx of foreign capital until the political and economic uncertainty has been resolved.

Greece would also be giving up the long-run benefits of euro membership, such as increased trade and competition, a more-efficient allocation of resources, a greater capacity to insure against risk that comes from unfettered access to European markets, and the greater stability that comes from delegating the conduct of economic policy to more effective institutions outside of Athens. The complexity of creating credible domestic-policy institutions in the aftermath of a Grexit should not be underestimated. Furthermore, a post-Grexit Eurozone would be more susceptible to speculative attack – investors would quickly start to demand sizeable compensation for the risk that they may not be paid in euros in a future break-up scenario. Capital would fly out of the countries concerned.

Source: adapted from *The Wall Street Journal*, 1 April 2015

Figure 1: Greece vs Euro Area

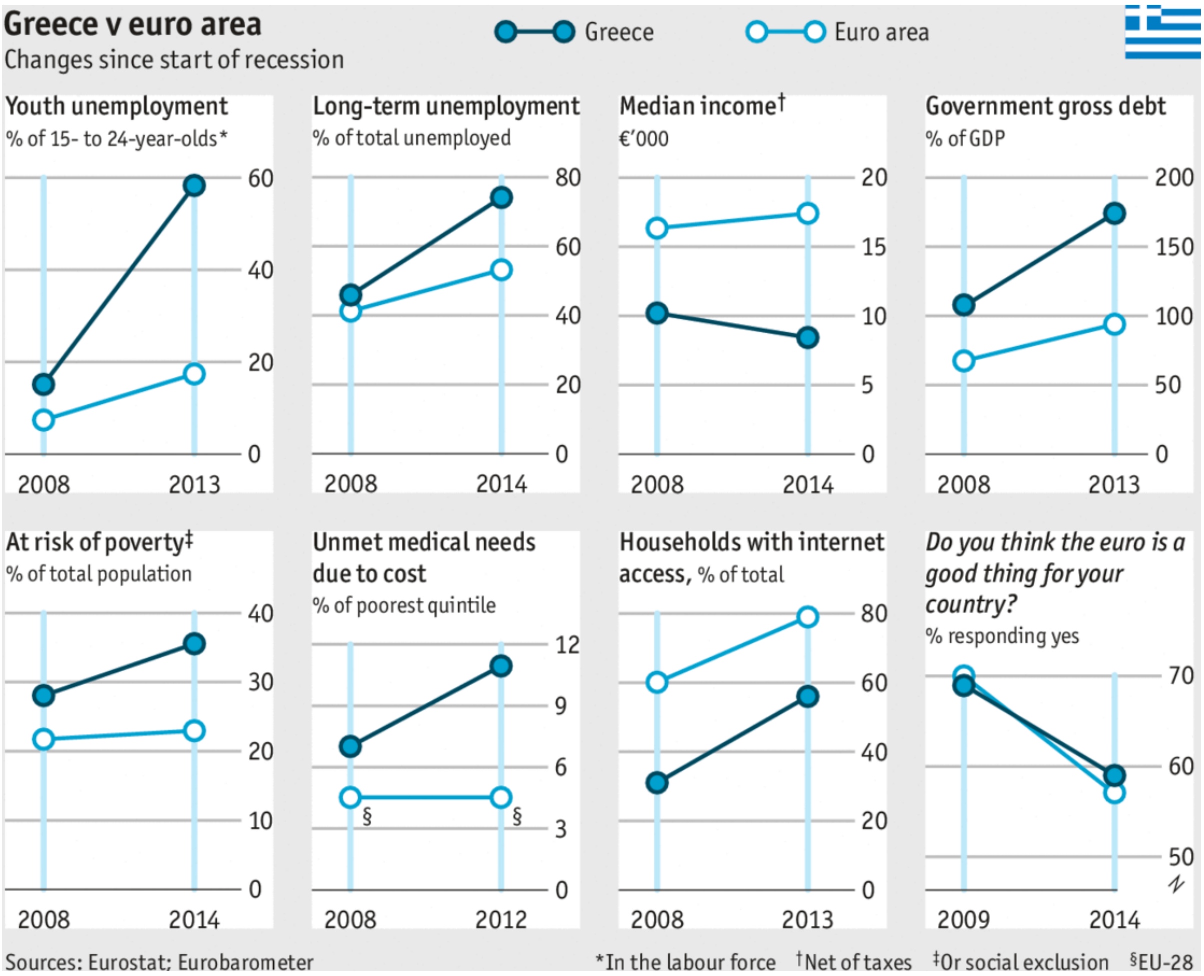
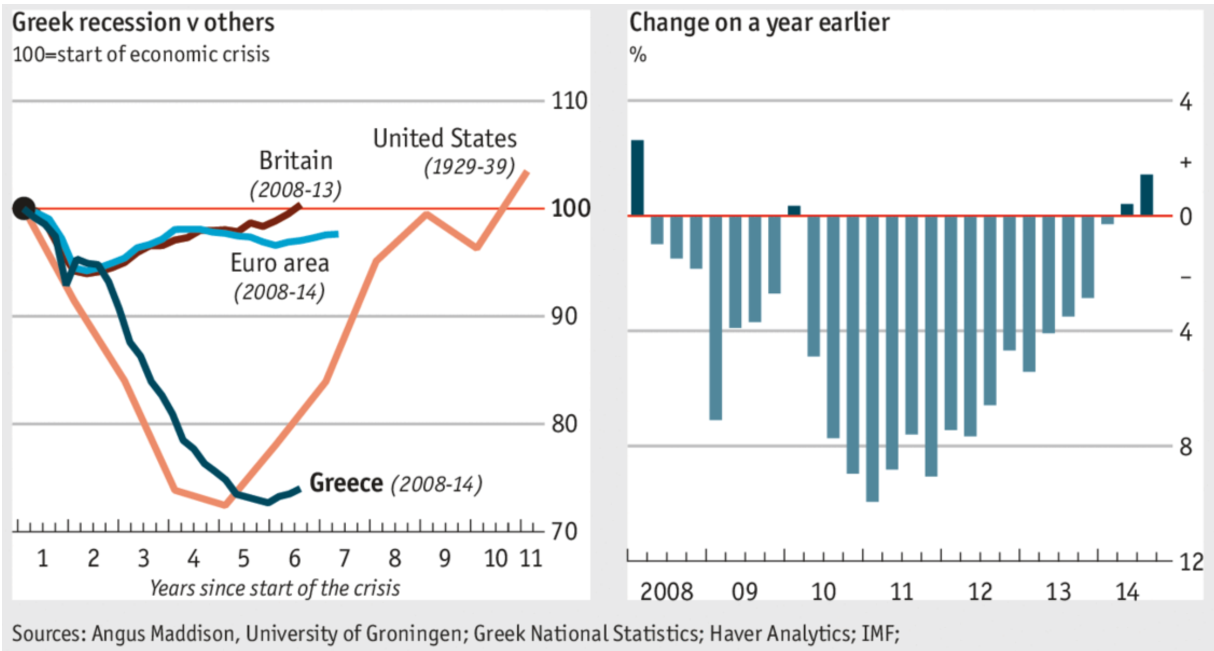
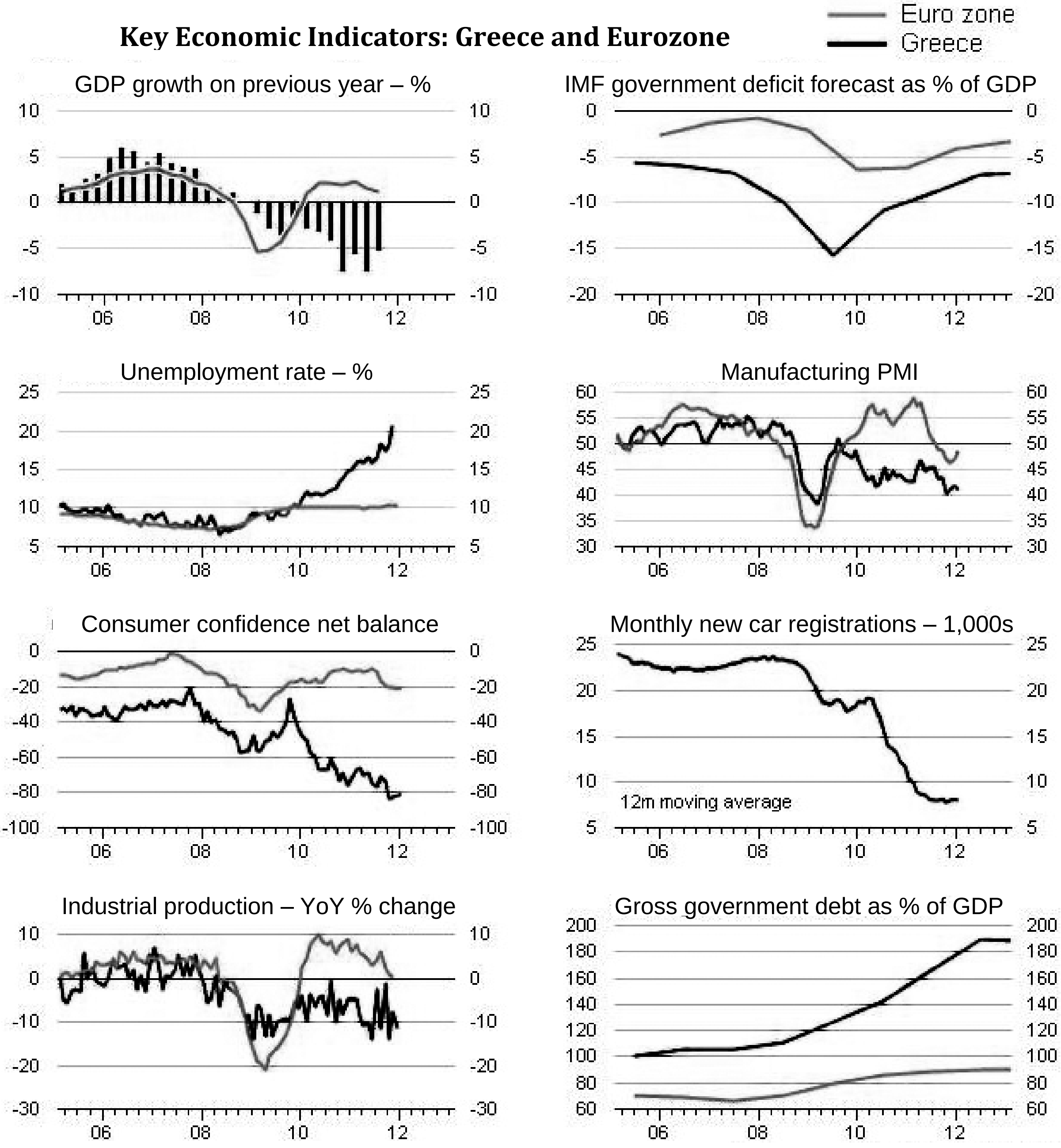


Figure 2: Greece's GDP



Source: The Economist, 4 March 2015

Figure 3: Greece Economic Overview



Source: *Thomson Reuters Datastream*, 9 February 2012

Questions

1 (a) Explain how the bailout of financial institutions like Northern Rock would create problems of moral hazard. **[6]**

(b) Examine the case for sharing banking information in the European Union (EU). **[4]**

(c) Would you support a Greek exit (Grexit) from the Eurozone? Discuss. **[10]**

(d) Evaluate the argument that 'severe, indiscriminate cuts to vital social protection programmes are not only economically self-defeating, but fatal'. **[10]**

[Total: 30m]

Section B

Answer **two** questions from this section.

2. Economics is a study of human behaviour. A solid grounding in theory and numeracy is essential but so, too, are broad dashes of politics, history, sociology and common sense.

Adapted from *The Telegraph*, 19 October 2013

Assess the extent to which the diverse components of the subject invalidate the claim that Economics is a true science. [35]

3. A government constitutes a group of people who takes calculated risks in decision-making for a country, so as to promote and maintain welfare of its people.

Discuss why a government, such as the US government, engage in demand-management policies despite the risks involved. [35]

4. The “Law of the Single Price” postulates that there is a uniform price in the respective markets within the country and across countries, and price differences are quickly eliminated by arbitrage.

Adapted from *Joseph E. Stiglitz*, Library of Economics and Liberty

Discuss this view. [35]

5. Assess whether strategies employed by firms in attempting to gain a competitive edge in the marketplace are likely to raise profits and reduce efficiency. [35]

6. Formula 1 (F1) is the world’s most-watched annual sports series. Hosting an F1 race puts the emerging economies on the sporting map alongside developed countries. Governments of emerging economies are prepared to fund the race.

Discuss whether governments of emerging economies should invest in these events. [35]

7. Economist and global strategist Pankaj Ghemawat argues that the differences between countries are still significant and are actually larger than generally acknowledged. He believes that "semiglobalization" is the real state of the world now and for decades to come.

Discuss this view. [35]

End of Paper